U.S. Department of Commerce
Bureau of Industry and Security

Update 2011 Conference

Remarks of
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I. Thank You's

Thank you, Eric, for the kind introduction. Thank you also for your leadership of BIS with integrity, vision, and, humor. The honor of working with you and the rest of the BIS team to advance the country's national security and economic security interests continues. For those of you in Export Administration, thank you again for your hard work, professionalism, and dedication. Special thanks go to Bernie Kritzer and Toni Jackson and your Exporter Services team for putting together yet another terrific Update conference.

Thanks to the congressional staff for attending. Our discussions on issues of common interest continue to be productive, and there will be many more. Special thanks also go out to my colleagues from the other departments involved in export controls and the other parts of BIS's mission. The reform effort is truly an interagency effort. Although we are clearly not done, we could not have gotten as far as we have without your commitment and hard work. And speaking of commitment and hard work, I particularly want to thank the NSC's Brian Nilsson for his terrific leadership of the Task Force and all the other work he does to work through the amazing number of issues associated with Export Control Reform.

For those of you in the audience who knew me before I joined the government last year, I continue to do well, do good, serve the country, and have fun. And, yes, people still laugh at my jokes a lot more than they used to.

II. General Goals

Speaking of my life before joining the Administration, I spent almost my entire career navigating the Export Administration Regulations (EAR), the International Traffic in Arms Regulations (ITAR), Treasury's sanctions regulations, and most of the other international trade laws and regulations. Even for a lawyer from Missouri, they are complex. And applying them to real world situations was often as much an application of lore as it was law. For small- and medium-size companies that have more limited resources and staff, compliance with the export control rules is even more daunting, thus exposing them to more transactional risks.

The results of this overly complex system are clear -- legitimate U.S. exporters are disadvantaged because of high compliance costs and the potential loss of market share because foreign

customers do not want to deal with complicated U.S. rules and unnecessary collateral controls, while scofflaws are able to use our system's flaws and complexities to skirt legitimate U.S. Government restrictions. The President's Export Control Reform Initiative aims to address these problems head-on.

In light of this real world experience, I have had three general priorities since joining BIS. The first is to ensure aggressive compliance with the laws and regulations that we have now. The rule of law governs even during a reform effort. Second, I've tried address the biggest problems that exporters face on a day-to-day basis, such as unnecessary impediments on trade with close allies, becoming more reliable and predictable suppliers generally, and dealing with the (real or imagined) overlap between the U.S. Munitions List (USML) and the Commerce Control List (CCL). In the long-term, my priority is to address the compliance burden faced by exporters subject to the U.S. export control system.

To date, BIS has published two significant regulations to address overly burdensome dual-use controls. Last year I reported about the June 2010 encryption rule that streamlined some of the controls on electronic items, which also enhanced national security by getting the government the information it needs in a format it needs. And last month, BIS implemented a new license exception that facilitates exports of almost all dual-use items to allies and partners as outlined by Eric. Bill Arvin will describe this new License Exception, Strategic Trade Authorization or STA, in more detail this afternoon at his session.

III. USML-CCL Rule

A. General Comment

Most of my comments today, however, will get into the tall grass of the next step in the reform effort – the structure for how militarily less significant defense articles eventually moved from the USML will be controlled on the CCL. We published a Federal Register notice last week that describes the background, process, and the content of the plan. We also issued a fact sheet today to provide additional guidance. It is, however, such a significant and lengthy proposed rule and a novel approach to tailoring controls on defense articles consistent with our multilateral commitments and national security that I want to make sure you understand its basic elements, structure, and the background. The more you understand about what we are proposing, the better your comments on it will be. And we really want your comments. If it works and you think it achieves the President's objectives, then let us know. If we have missed something or would create unintended consequences, then let us know that, too. If we have not drafted something clearly, send us some suggested wording for us to consider. One of the key aspects of the reform effort is making American companies more reliable and predictable exporters consistent with the national security objectives of controls. If we're not doing that, then you've got to let us know.

For those who want to move from the tall grass and down into the weeds, Deputy Assistant Secretary Matt Borman will discuss more details in his presentation during the interagency panel tomorrow morning. In addition, I and my staff will get in to the roots of the topic during a question and answer session Thursday morning at 8 am in the Latrobe Room. I'll also begin again next Wednesday the weekly open, public conference calls to answer questions about the proposed regulation.

I will then switch metaphors completely and summarize these changes and a vision for export control reform on one page through the use of an image of an iceberg.

B. Reason for the USML-CCL Rule

Why are we proposing a newly structured USML and "Commerce Munitions List" within the CCL, in addition to all other reforms? National Security. It's that simple. As still best described by former Secretary of Defense Gates in April 2010, our national security will be strengthened if (i) our export control system allows for more interoperability with our NATO and other close allies, (ii) our industrial base is enhanced by, for example, reducing the current incentives for foreign companies to design out or avoid U.S.-origin content, and (iii) our resources are more focused on controlling or prohibiting, as needed, the items that provide at least a significant military or intelligence advantage to the United States.

The statutory foundation of the USML-CCL plan is section 38(f) of the Arms Export Control Act, which states that the "President shall periodically review the items on the U.S. Munitions List to determine what items, if any, no longer warrant export controls under [the Act]." The President and his Administration are still making such determinations, but it is certain that he will decide that a significant number of defense articles – largely less significant generic parts, components, accessories and attachments that are defense articles merely because they are specifically modified for a defense article – no longer warrant controls under the Arms Export Control Act.

These determinations will be reflected in what the Administration does not positively identify in the revised U.S. Munitions List categories it is working on now. Recall, as described in our December Federal Register notices, a "positive list" is one that uses objective parameters and descriptions of what is controlled, rather than open-ended, generic, catch-all, or design-intent based standards. The point of the effort is to be objective (in order to reduce jurisdictional disputes and confusion) and, at the same time, control on the USML only those items that provide at least a significant military or intelligence applicability that warrant the controls that the Arms Export Control Act requires. These controls, as implemented by the ITAR, include registration, worldwide licensing on a purchase order-by-purchase order basis, the application of the "see through rule" (through the absence of a de minimis exception), and mandatory retransfer and reexport approvals in all cases.

In other words, if there is something that is so militarily significant that we would not want it exported for ultimate end use by one of the 36 STA-eligible close ally and partner governments without a specific, individual license and all the other collateral controls imposed by the Arms Export Control Act, then it should be listed on the USML. If not, then it will generally be identified as an item to move to the CCL's new "600 series" that I will describe in a moment.

Before the President may make any such jurisdictional changes, however, the Administration must notify Congress and wait 30 days before removing any such items from the USML. The notice must "describe the nature of any controls to be imposed on that item under any other provision of law." Thus, another purpose of the proposed rule is to describe to Congress how items the President determines no longer warrant control under the Arms Export Control Act would be controlled by the EAR once the congressional notification process is completed and corresponding changes are made to the USML and the CCL.

C. Some Details of the USML-CCL Rule

As described in more detail in the proposed regulation, we are creating a new "600 series" set of Export Control Classification Numbers (ECCNs) to control the defense articles that move to the CCL from the USML as well as other Wassenaar munitions list items that have been subject to the CCL for nearly two decades now. The new "600 series" would be an extension of the

existing series hierarchy in the CCL for items controlled by the various multilateral export control regimes. This aspect of the proposed rule reflects another theme of the effort, which is to create a structure for controlling on the CCL former defense articles while altering the basic structure of the EAR and the CCL as little as possible.

Some have asked how we can control military items on the CCL when the CCL is a "dual-use" list. The CCL was never a completely "dual-use" list because it controls some purely civilian items for foreign policy and other reasons and has controlled some purely military items for several decades that didn't warrant AECA controls. The more precise description of the CCL is that it controls commodities, technology, software, and some services that do not warrant control by one of the other export control agencies but nonetheless warrant some degree of worldwide or other control. The creation of the "600 series" is just a significant expansion of that long-standing concept.

We will informally refer to this new "600 series" of items as the "Commerce Munitions List." Having all such items in one series will allow for a straightforward application of a licensing policy for items that move to the CCL from the USML. It would also be a necessary intermediate step to eventually creating a single control list, which was announced by the President at last year's Update Conference.

Exporters will classify items moving from the USML to the CCL against existing ECCN entries first. If the item does not meet one of these existing control parameters, exporters will classify their item against the "600 series." The fourth and fifth ECCN characters of each new "600 series" would track the Wassenaar Arrangement Munitions List categories for the types of items at issue. The Wassenaar numbering structure for the last two characters would be used rather than the USML numbering structure to demonstrate the United States' commitment to control all Wassenaar Munitions List items and facilitate multinational companies in classifying their products in the United States and abroad.

D. Licensing Policies for "600 Series" Items

The rule proposes that items in the "600 series" require a license for export or reexport to all countries except Canada, unless a license exception is available. Multilaterally controlled items moved from the USML to the CCL would retain their regime control parameters and reasons for control, even if added to an existing ECCN or added to a new "600 series" ECCN.

Each new "600 series" ECCN will have three basic parts: controls on "end items," controls on generic "parts," "components," "accessories," and "attachments" that are "specially designed" for a specific CCL or USML entry; and specific parts and components that warrant no more than AT-only controls.

All "600 series" items would be subject to a general policy of denial when destined to a country subject to a United States arms embargo. We are, in essence, transferring the prohibitions of ITAR section 126.1 in to the EAR with respect to "600 series" items. The proposed rule would also restrict the use of license exceptions to export or reexport "600 series" items to countries subject to a United States arms embargo.

E. License Exceptions for "600 series" items

For all other countries, License Exception LVS, TMP, RPL, and GOV would be generally available for "600 series" items. Other exceptions, such as APR, would not be. License

Exception GOV would only be eligible for exports to one of the STA-36 countries for ultimate end use by a government of one of the 36 countries.

For "600 series" end items, however, STA is not automatically available. Applicants will need to request that it be made available for the type of end items at issue. If the Departments of Defense, State, and Commerce agree that such end items are eligible for export under STA, then BIS will publish the determination for others to rely upon.

"Specially designed" parts, components, accessories, and attachments would, however, automatically be eligible for export under STA for ultimate end use by a government of one of the STA-36 countries.

The ultimate government end use condition for the use of STA is proposed because its purpose is to facilitate interoperability among allies, not promote the commercial sale of inherently military items without U.S. Government advance knowledge and approval. From a national security perspective, we want to know who and for what purpose foreign commercial businesses are seeking to purchase munitions items.

F. Specially Designed

We have also proposed a single definition for the term "specially designed" to be used across both the EAR and the ITAR to create an objective standard for exporters and, just as importantly, prosecutors in determining whether a license is required. While touting the creation of a definition for "specially designed" may sound arcane to the casual export control observer, to those of you that live and breathe export controls on a daily basis, this definition will create a clear line for determining the eligibility of an item for export under a license or license exception. In other words, it is another example of a higher wall that we have erected to make our system more focused and enforceable.

I will answer questions about it during the open sessions I'll conduct on Thursday on the proposed rule because, yes, it is complex upon first read, particularly because it is such a novel approach to the issue. I, however, want to summarize the purpose and structure of the proposed definition here.

As we described in December, a core element of the positive USML review exercise is to avoid using design-intent based control parameters for generic items. The Administration has nonetheless determined that it cannot completely eliminate "specially designed" as a control parameter. The term is commonly used in the multilateral export control regimes' control lists upon which much of the CCL and USML are based. A basket category for controlling militarily less significant items "specially designed" for defense articles that move to the CCL is still necessary to achieve the larger national security objectives of the reform effort. Creating a positive list of the tens of thousands of such parts, components, accessories, and attachments that warrant some degree of control is not practicable.

Our goals for the single definition are that it:

1. Preclude multiple or overlapping controls of similar items within and across the two control lists;

2. Be capable of being easily understood and applied by exporters, regulators, prosecutors, and juries;

3. Be consistent with definitions used by the international export control regimes;

4. Not include any item specifically enumerated on either the USML or the CCL, and, in order to avoid a definitional loop, not use "specially designed" as a control criterion;

5. Be capable of excluding from control simple or multi-use parts such as springs, bolts, and rivets, and other types of items the U.S. Government determines do not warrant significant export controls;

6. Be applicable to both descriptions of end items that are "specially designed" to have particular characteristics and to parts and components that were "specially designed" for particular end items;

7. Be applicable to materials and software because they are "specially designed" to have a particular characteristic or for a particular type of end item;

8. Not increase controls on items controlled currently at lower levels; and

9. Not, merely as a result of the definition, cause historically EAR controlled items to become ITAR controlled.

A definition that we think meets all these goals is the one in the proposed regulation. BIS seeks public comments particularly on whether there would be any anticipated change in controls based on adoption of this definition. Through this proposed definition, if an item is "specially designed" today, it would continue to be "specially designed" after adoption of this definition. If it is not "specially designed" prior to adoption of the definition, it also should not, except in rare cases, become "specially designed" after adoption of this definition in a final rule. As a result, BIS strongly encourages the public to report any instances in which the proposed definition produces different results from the current definition. Such comments should describe the item and why the commenter believes that the item at issue is not now "specially designed" but would be as a result of the application of the new definition.

G. General Comments

When fully implemented, we believe that the vast majority of items on the Commerce Munitions List will be destined for the 36 countries eligible under License Exception STA, once again fulfilling Secretary Gates' vision of facilitating exports to close allies and partners to address interoperability problems inherent in the current export control system – while still aggressively controlling such exports to other destinations, particularly the countries subject to U.S. arms embargoes.

In this regard, we are soliciting your help. My colleagues from the Department of State, with assistance from the Department of Defense, have been able to process munitions licenses in 17 days on average. When many of these items are moved to the more flexible Commerce Control List, we want to ensure that we do not create an unintended consequence of delaying the issuance of licenses based on BIS's current average processing time of 31 days. We would appreciate the public's input on how to ensure Commerce processes keep pace with the historical averages of the Department of State.

H. Next Steps

Our next step is to focus on rebuilding the USML categories that will have the most impact for exporters. In addition to our first test case, Category VII, we are looking at the naval vessel and aircraft categories, VI and VIII, to begin the process of populating the Commerce Munitions List. Rewriting Category XI-Military Electronics also will have a significant impact for exporters and is a priority.

Over the coming months, State and Commerce will publish complementary proposed Federal Register notices that identify what items are subject to which list. We will then notify our oversight committees on Capitol Hill and eventually publish final versions of rebuilt USML categories and newly populated "600 series" ECCNs to implement this approach.

IV. Other ECR Activities

Our principal advisory committee on export control reform, the President's Export Council Subcommittee on Export Administration, is outlining its priorities for reform. Consistent with our view, completion of the USML-to-CCL process is expected to be its number one priority. Its other priorities also are expected to align with the Administration's workplan for the remainder of 2011 and into 2012, including:

1. Issuance of a proposed single form applicable to the export control regulations of Commerce, State, and Treasury later this year. Of significance, this form will rely on common definitions of similar terms across the three sets of regulations to further harmonize the control lists.

2. Completion of the transition of Commerce and State onto the USXPORTS licensing platform, which will create new efficiencies for licensing officers and allow the Administration to start work on a more sophisticated industry portal for submission of export license applications. We also are working to upgrade our consolidated screening list of more than 24,000 related entities to provide additional user-friendly features and updates.

3. Completion of the effort to tier of the Commerce Control List.

V. Compliance Iceberg

Once the list work is moving toward completion, I can turn my attention to the effort of streamlining compliance burdens. I often use the analogy that the export control system is like an iceberg. Most people focus on the number of licenses the system requires. I agree that the imposition of unnecessary license requirements creates a drag on U.S. competitiveness, which is why the first part of the reform effort has been focused on licenses involving items and end-users that are affected most significantly, particularly with respect to trusted allies and partners and military parts and components. However, for those of you that work through our export control regulations, I understand the level of complexity and burden hours involved with classifying your products, knowing your customers, and understanding the multitude of licensing policies unique to specific products, end-users, and destinations.

The Export Control Reform "Iceberg" aptly describes the compliance burden that the export control system imposes on exporters. The "above the water" tip of the iceberg represents both the dual-use licenses that can be eliminated by the use of STA as well as the potential melting of the volume of the iceberg that could be achieved if generic parts and components were to be moved from State to Commerce and become exportable under STA. But like most icebergs, there remains the "below the waterline" compliance burden on industry based on complexity, outdated control lists, numerous and sometimes irrelevant license conditions, and divided controls across the various regulations of three agencies. We are committed to preventing the continued underwater growth and drifting of the iceberg by eliminating unnecessary requirements and providing you with the clarity and flexibility to make responsible compliance decisions. (The penguin is not drawn to scale.)

To put some dollar values to these burdens, our Office of Technology Evaluation recently conducted a survey of companies involved in the manufacture of satellites to assess the impact of export controls on their operations. While the compliance costs as a percentage of total foreign sales for primes and integrators were between 1-2%, the total costs to such companies were $60 million annually. Even more stark was the compliance cost burdens for parts and component manufacturers, who tend to be small- and medium-size companies that provide the innovation for the space industry. Approximately 8% of revenue from foreign sales goes toward export control compliance costs. That is a significant drag on the competitiveness of companies, and we must address it.

Later this year, BIS will be issuing a Federal Register notice soliciting public comments on efforts that can be taken to streamline and clarify the EAR. We also are reviewing the public comments we received earlier this year on making the CCL a more positive list. Our goal is that by the end of 2012, we will have a comprehensive proposal to simplify the EAR and start addressing the regulatory compliance burdens that drain tremendous corporate resources but are not visible to the casual observer – while still having a set of regulations that address the key national security, foreign policy, and other objectives of export controls.

VI. Conclusion

Fundamentally reforming the export control system is a time-consuming process. Even with the departure of Secretary Gates and impending departure of Secretary Locke, we have White House commitment to complete the job. We are committed to seeing the job through, too.

Our goal is to find that sweet spot between facilitating trade to trusted end users and ensuring that sensitive items do not find their ways into the hands of entities and nation states that seek to undermine our national security. It takes a collection of activities from all interested stakeholders – exporters, export counselors, licensing officers, enforcement agents, and prosecutors – to make our system effective. But its underlying foundation must be strong. That's what the President's export control reform initiative aims to do.

Our accomplishments to date, particularly with regard to the list reform structure, are significant. We must now make them consequential by putting them into force. Commerce's encryption and STA regulations represent an important start. We must now finish the rewrite of the U.S. Munitions List and complete the tiering of the Commerce Control List to set the stage for final harmonization and work toward our ultimate vision of a single control list, within a streamlined regulatory construct, administered by a single licensing agency operating on a single information technology platform, and enforced by a single primary export enforcement coordination agency.

The control list changes are the key to reform in the short-term, and addressing unnecessary compliance burdens is the key to long-term fundamental reform. I hope you share my enthusiasm for our progress and vision.

I look forward to meeting with you during this conference and listening to your constructive suggestions. Thank you.